Crop Hail Advisory Task Force

Report

To

Commissioner Jim Poolman

September 2003

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BACKGROUND

Commissioner Jim Poolman, recognizing how important agriculture is to the State of North Dakota and how critical having a viable crop insurance program is to the producers of the state, summoned a representative sample of stakeholders in the crop insurance market to review the Department's current crop hail program.

The current crop hail insurance filing program was initiated in the 1980s and has evolved to its present form today. The prime reason it was created was to provide some stability, consistency and an even playing field for the industry, agents and farm producers.

With the recent trends and issues facing the insurance industry in general and the crop hail insurance market in particular, the Commissioner felt it was an appropriate time to do a critical review of the crop hail filing process. This could best be done by opening the issue for analysis and debate to a representative sample of experienced stakeholders who could be entrusted to conduct an objective analysis of the program.

Accordingly the Crop Hail Advisory Task Force was instituted for this purpose. The task force met July 28-29 and August 11-12, 2003, at the State Capitol to accomplish this task. This report is the result of those deliberations.

TASK FORCE PARTICIPANTS

The following were invited to participate either in person or by providing input:

<u>Agents:</u>

Larry McGillis – Agent – Mayport
Warren Flath – Agent – Bowman
Kent Olson – NDPIA – Bismarck
Howard Olson – Farm Credit – Fargo

Insurance Companies:

Nodak Mutual – Scott Askerooth
National Farmers Union
- Mark Classen
- Steve Heverly
- Robert Haney

Great American – Dean Clarke
Farmers Mutual Hail – Walt Jones

Farm Producers:

Gary Nelson – FSA/Casselton
Alan Lee – Berthold
Mark Kelner – Bowman
Harlan Klein – Elgin

Advisory Organization:

National Crop Insurance Services
- Theresa Stom
- Frank Schnapp

Insurance Department:

- Larry Maslowski – Director, Consumer Protection-PC Unit
- Mike Andring – Property and Casualty Actuary

MISSION STATEMENT AND SCOPE

North Dakota Insurance Department Mission Statement

It is the mission of the North Dakota Insurance Department to protect the public good by fairly and effectively administering the laws of North Dakota. We are committed to vigorous consumer protection efforts while fostering a strong, competitive marketplace that provides consumers with choices and access to high-quality insurance products and services at competitive prices. In pursuit of our mission, we will treat all of our constituencies with the highest ethical standards and respect they deserve.

Crop Hail Advisory Task Force Mission Statement

It is the mission of the Crop Hail Advisory Task Force to review and analyze the current crop hail policy, form and rate filing process and to report to the Commissioner of Insurance with its findings. Recommendations will be based upon a consensus of the task force members and will adhere to the overall mission of the North Dakota Insurance Department

General Scope of Project

1. Review and analyze the current crop hail policy, form and rate filing program.

2. Identify issues and concerns with the current program that impact farm producers, agents, lenders, and insurance companies.

3. Provide a consensus report to the Commissioner of Insurance identifying recommendations and/or solutions for responding to the issues and concerns for his consideration.

4. Identify in the consensus report those issues which the task force could not reach a consensus on and the reasons a consensus could not be achieved.

ISSUES IDENTIFIED BY TASK FORCE FOR DISCUSSION WITH CONCLUSIONS

The following list of issues represents those issues the task force members choose as issues to discuss. Each issue was phrased as a question with the task force offering both pros and cons to the issue. The task force then made a decision. If there was a general consensus (no dissenting vote), it was so recorded. If there was not a general consensus, it was so recorded with a reason why consensus could not be reached. Finally, the task force chose to prioritize each issue by indicating whether it was a high, medium or low priority item. The list is, therefore, grouped by priority with those of a high priority listed first. The list of issues is separated into two main categories—those pertaining to forms (coverage) and those pertaining to rates (including rules and filing procedures).

Forms

High Priority

1. Automatic carryover coverage – Should automatic carryover provision be prohibited from policies?

   PRO – Removal of this provision would force the farmer to use more of a risk management approach. The concept for this was based primarily on marketing and as a way to tie a consumer to a company. There is a potential hazard to the farmer in that the amount of coverage carried forward may be inadequate depending upon the year/crop. There is concern with the fact that you are telling the farmer that this year's policy provides the carryover coverage, when in fact the conditions applied at the time of loss require the insured to actually implement a new policy and claims are paid from the new policy not the old. This also causes potential issues for companies and insureds who might want to discontinue or change a policy form (deductible) but are locked into the old. There is some concern that the rates for policies with this feature are not quantifiable or justifiable at this time.

   CON – Allows the farmer to delay in making his final decision. This may be viewed as free insurance. May require legislation to accomplish.

   DECISION – The consensus by the task force was that the provision should be eliminated.

Medium Priority

None Listed

Low Priority

1. Effective time of the policy – Should the law be changed so there would be a waiting period as opposed to the current immediate coverage capability?

   PRO – Going to a waiting period would eliminate adverse selection and stabilize the business environment.

CON – Not having a rigid waiting period gives the farmer more flexibility allowing him to take into account seasonal delays, etc. Companies are watching this more closely in recent years and have modified their requirements, i.e., fax, time delays, etc. Companies need to have some flexibility as well. The overall situation has improved and previous problems seem to not be as significant with the companies' changes and some of the companies with loose standards now not in the market. Reinsurance companies are watching this more closely and have tightened requirements to companies. This would require a legislative change.

DECISION – The consensus by the task force was to leave the law the as it is.

2. Sales closing date – Should a sales closing date be mandated (applicable to both initial applications and subsequent policy changes in coverage)?

PRO – A definitive sales closing date would eliminate gaming, abuse and adverse selection. It would force the farmer to risk manage rather than storm manage. If implemented, could provide for buy back/buy down features if initial decision/limit was too high.

CON – While MPCI uses a sales closing date no other state requires one for crop hail. A farmer often does not know what the crop looks like till later in the season. The policies are written on an Actual Cash Value basis. Lenders may require coverage. Companies currently have the ability to set company sales closing dates. This would most likely require a legislative change to implement.

DECISION – The consensus of the task force is not to recommend mandating a sales closing date.

3. Over-insurance – What can be done to prevent over-insurance when two or more policies are issued on one crop?

PRO – None given.

CON – This is a company issue. Companies have the ability to underwrite and verify whether or not an insured is over insuring a crop. The standard policy allows for pro rate calculations when multiple policies are involved and are also Actual Cash Value (ACV).

DECISION – The consensus of the task force was not to pursue any action in this area but to continue to let companies manage the issue.

Rates

High Priority

1. NCIS loss cost formula use of most recent data – Should the NCIS loss cost development methodology be modified to reflect additional weight to account for more recent /dramatic changes in loss experience?

   PRO – Using a short term or span of time may make the loss costs more responsive to recent events but will be less predictable. The responsiveness may be a benefit in that it may encourage companies to stay.

   CON – An evaluation by NCIS shows that the cumulative average loss cost is a better predictor then a more heavily weighted to recent year formula. To the extent that more recent years of liability show significant increases in volume over the years previous, some weighting of the recent years already occurs. Using a shorter term results in more variability and less overall stability.

   DECISION – The consensus was the method for calculating loss costs is the best available predictor of future losses. No modification is recommended.

2. NCIS loss cost formula does not cross state or provincial borders (geographical area) – Should the township formula be modified for those townships along the borders so that the loss data for the surrounding area regardless of jurisdiction be used to determine a more accurate loss cost? If so, how?

   PRO – Townships residing on or near North Dakota borders would have more accurate data and loss costs if the geographical (adjacent area) was included in the 25 township formula.

   CON – There may be some difficulties in matching cross border townships, policies, and base crop data. This would require significant programming for NCIS.

DECISION – The consensus was that the Commissioner should request NCIS conduct a study of the mechanics, logistics and impact to loss costs of converting the system to be able to do cross border analysis.

3. Use of cups and caps on loss costs – Should the Department continue to require NCIS to cap and/or cup dramatic loss cost changes in townships? If so, what should the caps and cups be?

PRO – The current requirement is to cap/cup loss cost changes to no more than 30% up or down in a given biennial change. This helps to stabilize the rate in individual townships and protects an individual township from severe swings in rate. Companies are comfortable with keeping the current level in place. It was felt that farmers subject to potential wide swings in premiums would favor this.

CON – Removal would make a more responsive rate. With the exception of Kansas, South Dakota, Minnesota, and New Mexico no other state sets cups and caps. This is a Department imposed limit. NCIS is not in favor of using them. Farmers may not approve if they were aware that the amount exceeding the cap or cup for an individual township is offset against all townships. Caps prevent a township with recent years of bad experience from having an accurate FALC applied and may take years before the FALC reflects true experience.

DECISION – No consensus was reached. While there were those who supported the concept to stabilize swings, there were those who felt the pure statistical approach was the best method to use.

4. Department requires companies use only three loss cost multiplier levels to develop rates – Should the program be modified to allow for a broader range of multipliers or other alternative methods? If so, what methods?

PRO – Using a broader range would then allow companies to more accurately reflect actual costs and set rates using real expenses. It would provide more flexibility to companies. The current system assigns too much expense load to the higher rated, i.e., western areas. Try to avoid using mandated tiers. The only other state using tiers is South Dakota and theirs is optional. Tiers were arbitrarily set. This would take away the artificial nature of the tiers.

CON – The current system is more structured, more restrictive. It would make it harder for agents and consumers to compare rates between companies due to potential variability.

DECISION – The consensus was to modify the current three tiered system. The recommendation is to go to an open system allowing companies to apply their own system to the appropriate loss costs.

5. <u>Department currently permits a cash discount/surcharge of up to 5%</u> - Should the cash discount/surcharge rule be eliminated? If not, should it be modified to more accurately reflect the true time value of money?

   PRO – A basis for the discount is the time value of money, but the actual time period 7-1 to 10-1 does not support the high level of discount.

   CON – Farmers that use this feature provide capital and cash flow to the company. It is recognized as a marketing feature driven by competition. It should be left to the companies to decide if they want to utilize. Companies should be required to justify the use of it actuarially by demonstrating the time value of money. Some farmers can benefit from it.

   DECISION – The consensus was to keep the rule permitting the cash discount/surcharge but recommend a cap of 2% due to the current financial climate but permit higher discounts if the company can justify its use.

6. <u>Department currently requires the most recent five years of expense data from a company to support a rate change</u> – Should this requirement be modified to eliminate the need for the most current year or change the number of years all together?

   PRO – The requirement is one artificially set by the Department. It is hard to get final year end data cleaned up by February 1. Allow companies the option of using most current year expense. A benefit to eliminating the most recent year is to be able to move up the filing deadline which will benefit companies, agents and farmers and speed up the process. North Dakota is the only state that requires five years; most ask for three years. Companies believe three years is a better representation.

CON – This forces the Department and companies into using a later filing deadline. There could be a concern whether companies have appropriate reinsurance in place by the regular February deadline.

DECISION – The consensus was the companies should not be required to use the most recent year expense but have the option to do so if the could, and that the requirement for five years of data be changed to three years.

7. <u>Department does not accept a company filing that includes a fixed expense factor in calculating a rate</u> – Should the ability to use a fixed expense component (in addition to the variable expense component) be permitted?

PRO – Companies are capable and actuarially it is possible to identify some expenses that are not variable and each company should be allowed to use this methodology when filing there rates. Rates would more accurately reflect actual cost. The current restriction is artificial in that it is set by the Department.

CON – It is not clear what a fixed expense is (lack of definition). Companies who file would need to be educated in this process. Justification may be more difficult in this area.

DECISION – The consensus was the Department should permit the use of fixed expenses subject to appropriate actuarial justification.

8. <u>Expected loss ratio ELR caps/cups</u> – If the Department eliminates the mandated three tier system but permits companies to file company based tiers, should there be a maximum ELR and/or minimum ELR set?

PRO – Having some parameters will add some stability to the process and prevent lowballing. We are concerned with the availability of coverage, anything to encourage companies to stay should be considered. Companies tend to like having some parameter.

CON – Any caps or cups would be artificially set by the Department. Companies if under an open system are accurately filing expenses should be allowed to set rate where appropriate for the expense. Will encourage more competition by not setting parameters.

DECISION – The consensus was that there should be cap on the maximum ELR that can be used at the high range of loss costs and it should be 70.

9. <u>Department has accepted company filings with a projected zero profit load</u> – Should a minimum profit load be required? If so, what minimum is actuarially supported?

PRO – Requiring a minimum would encourage companies to participate in the state.

CON – Companies should be able to make own determination regarding profit load even if it is zero. The general offset to justify this approach is to use investment income then as the actual profit. It would be very difficult to quantify what a minimum profit load should be for all companies at this time. The proposed changes to the tiers should provide more accurate costing across the tiers thus addressing some of the issue with using a zero profit load. What basis can the Department refuse to allow a zero load.

DECISION – A consensus could not be reached. Opinion on both sides was strongly held.

10. <u>Department holds the companies to use of the NCIS rounding rule</u> – Are there other legitimate options for methods of rounding that would improve the process and eliminate inherent negative impacts, or should the Department continue to mandate a specific rounding rule?

PRO – Continuing to require the same rounding rule for all companies would provide stability and more consistency to the process. If more options are permitted, then it is likely there will be more rate groups used thus more rate pages needed.

CON – The Department has artificially set the one rule only. Companies should be able to use what ever appropriate rounding system they deem fit for their program. Companies should be required to file their rule to assure consistency.

DECISION – The consensus was companies should be able to set their own rule for the use of rounding.

Medium Priority

1. NCIS loss cost formula use of 25 townships – Should the NCIS loss cost development methodology be modified to increase the size of the area for determining individual township loss costs?

   PRO – Expanding the final average loss cost 25 township formula to encompass 49 townships would broaden the data base and smooth out the FALC.

   CON – The change would most likely change FALC's in all townships. Actual impacts are unknown at this time. All other states use the 25 township formula. NCIS could be asked to do a study on this issue.

   DECISION – The consensus was to keep the current 25 township formula with it present weighting factors but to recommend that the Commissioner request NCIS conduct a study of expanding the formula to 49 townships and determining what the best weighting method to use with the expanded area.

2. Department currently permits a discount for internet sales – Should this continue to be permitted? If so, what parameters should be applied?

   PRO – Currently the Department has no legal basis to refuse a justified request but does regulate. Needs to be actuarially based. Would help to define what constitutes internet sales. Forces competition.

   CON – Recent past reflects the failure of one company that tried to market using this method. There is a concern that farmers who are used to receiving service from a local agent will be left wanting when claims and other issues arise. There may be some insurance products that lend themselves to this type of marketing and have consumers savvy enough to use this method; however, there is concern that this product does not lend itself to this method. Many consumers may not be aware of the pitfalls of not having a local representative to work with. Represented by some that allowing this goes against the consumer protection aspect of the Department's mission statement (reference the recent failure). It is possible to justify an expense savings for the first year of an internet program. In subsequent years, however, a company's actual expenses would partially reflect the expense savings of an internet marketing approach, which suggests that any request for discount in subsequent years needs to be adjusted (reduced) for this potential duplication.

DECISION – Consensus was not to make a recommendation in lieu of the fact that the Department legally must consider requests of this nature, but to note that the Department should define and set parameters for justifying any requests.

3. <u>Companion plan rates are factored from other base rates and in some cases are thought to be inadequate for the risk</u> – Should there be a study of the methodology and experience to determine if the present system has some inherent flaws resulting in an inadequate rate?

   PRO – NCIS has plans to conduct such a study.

   CON – None.

   DECISION – The consensus was to recommend the Commissioner request NCIS conduct a study on the appropriateness of Comp rates.

<u>Low Priority</u>

1. <u>Traditionally the premium for the season's crop policy is fall billed (October)</u> – Should the system be changed so that the billing procedures for crop insurance are the same as for any other PC product, i.e., advance and/or installments? If so, how should it be changed?

   PRO – There was definite interest in requiring other methods similar to all other lines of insurance. This would enhance cash flow and avoid collections problems.

   CON – This is a company decision and should not be mandated. Historically this tied closely to the actual farming operation cash flow. Currently MPCI (federal program) uses the same practice.

   DECISION – The consensus was the task force felt that inclusion in this document would indicate there is a feeling that this system should be changed and that companies are encouraged to seek alternative payment systems to reflect current farming practices.

SUMMARY COMMENTS

During the course of the discussions the task force made decisions on what issues it felt were necessary to discuss and make recommendations on and those they felt they were not going to discuss. For the record the issues the task force discussed but decided not to debate were: requiring the use of NCIS loss costs, annual filings, filing deadline, rate analysis of western rates, prior approval filing system, deregulation, use of regional and countrywide data, and the prohibition on certain tie in discounts (volume, farm, federal crop, etc.).

The issues that the task force debated were deemed important to the ongoing viability of the Department's filing process taking into consideration the current state of the market in the state. The recommendations the task force feels are in the spirit of the mission assigned to it and hope the Commissioner will give serious consideration to implementing changes recommended therein.